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August 29, 2013

Ex Parte

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions, GN Docket No. 12-268

Dear Ms. Dortch:

On August 27, 2013, Charla Rath, Leora Hochstein, Christopher Oatway, Robert Morse, and Dan Vincent, Professor of Economics, University of Maryland, on behalf of Verizon, met with Gary Epstein and Edward Smith of the Incentive Auction Task Force; Brett Tarnutzer, Martha Stancill, Kate Matraves, Margy Wiener and Sasha Javid of the Wirelesss Telecommunications Bureau; Evan Kwerel and Steve Wildman of the Office of Strategic Planning and Policy Analysis; and Paul Milgrom, Ilya Segal and Jon Levin of Auctionomics. We emphasized that the Incentive Auction will only be successful if there is robust participation by both broadcasters and wireless operators. As the Commission has repeatedly stated, the goal of encouraging robust participation requires keeping the auction design as simple and straightforward as possible. We explained that T-Mobile's recent "Dynamic Market Rule" (DMR) proposal, combined with the bidding restrictions that T-Mobile and others urge the Commission to impose on Verizon and AT&T, would add substantial unnecessary complexity to what is already a very complicated two-sided auction. The result would be suppressed revenue compared to an unrestricted auction and a heightened risk of auction failure.

First, we noted that proposals to restrict Verizon's and AT&T's ability to participate in the Incentive Auction lack a factual foundation. For example, firms advocating bidding restrictions for Verizon and AT&T provide no evidence that they would be unable to acquire 600 MHz spectrum in the auction in the absence of such restrictions. Nor do they assert that they have been unable to acquire the spectrum they need in other auctions or in the secondary market. Furthermore, these firms do not demonstrate that they face spectrum constraints that would prevent them from competing effectively absent rules giving them special preferences in the Incentive Auction.

Second, we discussed the evidence supporting the common sense conclusion that prohibiting parties with an interest in acquiring licenses from participating fully in the Incentive Auction would artificially constrain demand. This, in turn, would prevent prices from rising to the levels they would under real demand conditions in an open bidding process. One of Congress's goals for the Incentive Auction is to raise money for public safety (FirstNet), but economic analyses prove that restricting Verizon and AT&T would risk substantially suppressing revenue.[1]

Proponents of bidding restrictions speculate that restrictions will instead promote the participation of smaller firms that might otherwise be discouraged by the unrestricted presence of larger firms. However, they supply no empirical evidence to support this claim. On the contrary, this conjecture is contradicted by the empirical evidence from spectrum auctions in the United States, which makes clear that smaller firms are not "discouraged" by the presence of larger firms. For example, in Auction No. 66 (the AWS auction), it was known that Verizon, AT&T and T-Mobile would participate without restrictions, yet a total of 168 qualified bidders registered for the auction and a total of 104 bidders won licenses during the auction.[2] This result is inconsistent with the assertion that "smaller" firms would be deterred from participating in the Incentive Auction if the Commission does not adopt bidding restrictions.

Third, we explained that far from mitigating the harmful effects of bidding restrictions, the Dynamic Market Rule proposal would overcomplicate an already complex auction and would heighten the risk of auction failure. The DMR proposal would restrict the number of 600 MHz licenses that Verizon and AT&T could each acquire in any particular market to one, or in some cases, two licenses. Under the proposal, the restrictions would gradually be relaxed on a round-by-round and market-by-market basis if a "revenue target" is not met during the auction.[3] Professor Vincent endorsed the critique of the DMR proposal written by economists Yeon-Koo Che and Philip Haile,[4] which captures the serious flaws inherent in the proposal, including increased bidder risk, lower auction revenues and significant strategic complexity. Professor Vincent explained that the DMR concept could not be modified to avoid these shortcomings and that introducing them to an already complex, multi-layered two-sided trading mechanism would greatly reduce the likelihood of a successful auction.

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[1] *See, e.g.*, Michael L. Katz, Philip A. Haile, Mark A. Israel, and Andres V. Lerner, *Spectrum Aggregation Policy, Spectrum-Holdings-Based Bidding Credits, and Unlicensed Spectrum*, Mar. 12, 2013, p. 20; Robert J. Shapiro, Douglas Holtz-Eikin, and Coleman Bazelon, *The Economic Implications of Restricting Spectrum Purchases in the Incentive Auction*, Apr. 30, 2013, p. 13.

[2] *See* http://wireless.fcc.gov/auctions/default.htm?job=auction_summary&id=66.

[3] Gregory Rosston and Andrzej Skrzypacz, *A Dynamic Market Rule for the Broadcast Incentive Auction: Ensuring Spectrum Limits Do Not Reduce Spectrum Clearance,* July 2013 (filed with *ex parte* letter dated July 31, 2013 from Trey Hanbury, counsel to T-Mobile US, Inc., to Marlene H. Dortch, Secretary, FCC, GN Docket No. 12-268).

[4] Yeon-Koo Che and Philip A. Haile, *Comments on T-Mobile's "Dynamic Market Rule" Proposal*, Aug. 13, 2013 (filed with e*x parte* letter dated Aug. 13, 2013 from David L. Lawson, counsel for AT&T, to Marlene H. Dortch, Secretary, FCC, in GN Docket No. 12-268).

Reduced Revenue Relative to an Unrestricted Auction. Professor Vincent also made clear that one fundamental problem with the proposal is that it would risk leaving billions of dollars on the table because it would result in lower revenues than an unrestricted auction. Whatever revenue target is set effectively becomes a revenue ceiling because unrestricted bidders would have an incentive to bid strategically to provide *just enough* revenue for the auction to close – but no more – in order to ensure that the restrictions on Verizon and AT&T are not relaxed. That way, the unrestricted bidders can avoid competing with Verizon or AT&T for the spectrum and thus acquire their spectrum at discount prices.

Strategic Bidding and Exposure Risks. Professor Vincent noted that one of the benefits of the simultaneous multiple round ("SMR") auction format that the Commission is contemplating is that bidders have the ability to alter their bidding strategies in real time in response to price information acquired in the course of the auction. The DMR proposal would short-circuit that important feature and would force bidders to express a demand that is insincere, expose bidders to an increased likelihood of a failed aggregation or, possibly more likely, induce bidders not to participate at all in order to avoid the risk of overpaying for an inefficiently small license or an incomplete portion of a desired footprint.

For example, to address one of the many strategic bidding issues created by their proposal (the concern that restricted bidders may withhold bids during early rounds to ensure that restrictions are lifted), T-Mobile's economists propose the following rule: restrictions would be lifted only on a market-by-market basis and only for restricted bidders who are actively bidding in particular markets. But that "fix" illustrates that adding additional complex rules to an already complex contingent reauction mechanism will *not* result in an auction that can be expected to function well. One exposure risk problem created by the proposed market-specific activity rule is that bidders would be unable to move demand across geographic markets, eliminating one of the important efficiencies enabled by the SMR framework. Another is that restricted bidders may be required to bid for an unrestricted license they do not want on its own in order to combine it with the additional restricted license that may or may not become available in subsequent rounds. The potential revenue-suppressing effect of that exposure risk is substantial. If a constrained bidder decides to avoid the risk of obtaining an inefficiently small license by not bidding in early rounds, the demand from that bidder will be lost for the remainder of the auction (and any subsequent relaxation of licenses or reduction of clearing targets would be less effective since this constrained bidder will be absent).

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The Commission should reject calls to prevent Verizon and AT&T from participating on equal footing with competitors. Not only are bidding restrictions unnecessary and contrary to the Commission's sound policy of assigning spectrum to its highest and best use, but they would suppress revenue and risk auction failure. Far from mitigating the revenue-suppressing effects of bidding restrictions, the DMR proposal would exacerbate them.

Sincerely,